

**TENNESSEE DEPARTMENT OF REVENUE  
REVENUE RULING #94-27**

**WARNING**

**Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.**

**SUBJECT**

Applicability of Tennessee sales and use tax to charges for consultation and software development services.

**SCOPE**

Revenue rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue rulings are advisory in nature and are not binding on the Department.

**FACTS**

The “Company” engaged the services of an independent firm to develop [BUSINESS] software to be implemented in [HARDWARE]. These devices will be distributed to all of the Company’s associated sales representatives, some of whom are in Tennessee. The development and implementation of the [BUSINESS] software involve four phases.

Phase I includes consultations and meetings with the Company to gather user requirements for the [BUSINESS SOFTWARE]. The information gathered from this phase is used to conceptually design the [BUSINESS SOFTWARE] and to determine the feasibility of the overall [BUSINESS SOFTWARE] project.

Phase II involves the design, construction, and testing of application software for the [HARDWARE] as defined by the requirements and conceptual design developed in Phase I.

Phase III involves the planning, performance, and evaluation of a pilot implementation of the [BUSINESS SOFTWARE] in three district offices. Consultation services provided by the software company will support the Company’s development of training courses, user documentation, and user support. Phase III will also involve software installation services into [HARDWARE] which will be shipped to [NUMBER] states.

Phase IV involves the implementation and roll-out of the [BUSINESS SOFTWARE] to the entire sales force of the Company. Consultation services will be provided to support the Company's team leaders in the deployment of the [HARDWARE] to all of its sales representatives. Phase IV also involves installation of the software into the [HARDWARE] for all associated sales representatives. Upon completion of Phase IV, the [HARDWARE] will be shipped to the Company's various locations in [NUMBER] states including Tennessee.

Charges for each phase of the project are separately stated in the contract and on the invoices.

### **QUESTION**

To what extent the charges for consultation and software development services performed for the Company are subject to Tennessee sales and use tax.

### **RULING**

The sales price subject to taxation includes all services performed for the Company because they are a part of the sale of tangible personal property. The items of tangible personal property must be sold or used in Tennessee to be subject to taxation in Tennessee.

### **ANALYSIS**

Several statutory provisions are relevant to the question at hand. Tennessee Code Annotated § 67-6-102(23)(A) (1994) defines a retail sale as a "taxable sale of tangible personal property or specifically taxable services to a consumer or to any person for any purpose other than for resale."

Tennessee Code Annotated § 67-6-102(24) (1994) defines, in relevant part, a taxable sale as follows:

(A) "Sale" means any transfer of title or possession, or both, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatsoever of tangible personal property for a consideration, and includes the fabrication of tangible personal property for consumers who furnish, either directly or indirectly, the materials used in fabrication work, and the furnishing, repairing or serving for a consideration of any tangible personal property consumed on the premises of the person furnishing, preparing or serving such tangible personal property;

(B) "Sale" also means such transfer of customized or packaged computer software, which is defined to mean, information and

directions loaded into a computer which dictate different functions to be performed by the computer, whether contained on tapes, discs, cards, or other device or material. For such purpose, computer software shall be considered tangible personal property;

Finally, Tennessee Code Annotated § 67-6-102(25) (1994) provides in relevant part that:

“Sales price” means the total amount for which a taxable service or tangible personal property is sold, including any services that are a part of the sale of tangible personal property.

The above statutes apply to the Company in the following manner. T.C.A. § 67-6-102(23). The sale or use of tangible personal property, which specifically includes computer software, T.C.A. § 67-6-102(24)(B), is subject to taxation. T.C.A. § 67-6-102(23). Services provided for the Company will be included in the taxable sales price if the services are construed to be part of the sale of tangible personal property. T.C.A. § 67-6-102(25). If no sale or use of the tangible personal property occurs in Tennessee, there is no taxable event, even if the services are performed in Tennessee.

The elements necessary to constitute a sale are transfer of title or possession of tangible personal property for a consideration. *Volunteer Val-Pak v. Celauro*, 767 S.W.2d 635, 636 (Tenn. 1989). Absent an explicit agreement between buyer and seller, title passes “at the time and place at which the seller completes his performance with reference to the physical delivery of the goods.” *Id.* at 637.

If a retail sale of tangible personal property does occur in Tennessee, the taxable sales price includes any services that are a part of the sale of tangible personal property. T.C.A. § 67-6-102(25) (1994). It must be determined, then, which services provided for the Company are part of the sale of the customized computer software.

Phase II involving the design, construction, and testing of software, Phase III involving the pilot implementation of the system, and Phase IV involving implementation of the system and installation of the software into the [HARDWARE] all must be considered part of the sale of the customized computer software. Phase I involving consultations and meetings with the Company to gather user requirements for the [BUSINESS SOFTWARE] also must be considered part of the sale of the tangible personal property and therefore subject to sales tax. If the contractor did not meet with the Company to gather information regarding the Company’s needs and requirements, the contractor could not design the appropriate customized software. Phase I services are therefore necessary in the development of the [BUSINESS] software.

The above analysis leads to the conclusion that all services provided for the Company are ultimately for the sale of tangible personal property and therefore subject to sales tax to the extent the sale of the tangible personal property occurs in Tennessee.

Use tax also applies if items of tangible personal property are sold out-of-state but then used in Tennessee. T.C.A. § 67-6-203(a). The use tax base is the “cost price” of the tangible personal property used. *Id.* “Cost price” for the purpose of the use tax is equivalent to the sales price which was paid on the purchase of the item. All services provided for the Company are subject to use tax to the extent the tangible personal property is used in Tennessee. The use tax is subject to the provisions of T.C.A. § 67-6-507(a) which provides a credit for sales tax properly paid in another state.

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